

Law and Business Review of the Americas

Volume 16 | Number 1

Article 5

2010

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Recommended Citation

Marcos Aurelio Pereira Valadao et al., *The (Not So) Great Depression of the 21st Century and Its Impacts on Brazil*, 16 LAW & BUS. REV. AM. 53 (2010)
<https://scholar.smu.edu/lbra/vol16/iss1/5>

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THE (NOT SO) GREAT DEPRESSION OF THE 21ST CENTURY AND ITS IMPACTS ON BRAZIL

Marcos Aurélio Pereira Valadão* & Ivo T. Gico Jr.**

ABSTRACT

At this point there are many papers discussing how the Great Depression of the 21st century came to be, its causes and the things that need to be changed in the world's financial market in order to overcome and prevent it from happening again. We would like to contribute to the debate by sharing some of the experiences we had in our own country that may shed some light on how it really affected developing countries, especially Brazil. This is the main purpose of the present paper, to discuss how the sub-prime international crisis affected the Brazilian economy, the counter-cyclical measurements the Government took, and how the country has reacted thus far.

Key words: Financial Crisis, Brazil, Latin America, Legal Measures, Recovery.

I. INTRODUCTION

At this point, there are many papers discussing how the Great Depression of the 21st century came to be, its causes, and the changes needed in the world's financial market to overcome and prevent it from happening again. We would like to contribute to the debate by sharing some experiences from our own country, Brazil, that may shed some light on how the crisis really affected developing countries. . The main purpose of this paper is to discuss how the sub-prime international crisis affected the Brazilian economy, the counter-cyclical measurements taken by the government, and the country's reaction thus far.

In order to better contextualize Brazil's situation, we will follow the international expectations for the crisis crystallized at the United Nations

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Conference on the World Financial and Economic Crisis and Its Impact on Development.¹ We adopt this approach not because we believe that these expectations are necessarily the best method for studying the crisis in any specific country, but because they adequately represent expectations of the broader international community on what should be anticipated in general from the crisis.

In the first part of this paper, we review each of the possible identifiable effects of the crisis on different countries and discuss whether it really happened in or affected Brazil. We will also discuss why such effects occurred and try to associate specific policies implemented by the Brazilian Government connected with those effects. In the second part, we evaluate Brazil's current economic situation and its standing in the world post-crisis. Finally, we present some conclusions regarding Brazil's future challenges.

II. INTERNATIONAL EXPECTATIONS AND THE BRAZILIAN ECONOMY DURING THE CRISIS

Beginning in 2007, an unexpected economic crisis swept around the globe. Beginning with the sub-prime financial market in the United States, the crisis gradually spread through the rest of the American financial market, contaminating its productive economy and dragging most countries in the world down with it. There is still some debate on whether the crisis was created by a lack of regulation, excessive regulation, or simply the failure to establish adequate public policies in a frustrated attempt to provide houses for those who could not afford them. But most scholars and authorities would agree that the crisis is probably rooted in inadequate regulations, speculative rational individual risk assessments that made no sense systematically, or both combined with clearly unsound banking and financial practices.²

Independent of its origins, the truth is that the crisis hit the U.S. economy hard. Until then, the United States had the most important economy in the world and its failure quickly contaminated other countries—rich, poor, and developing. When the crisis began, many closed economies like Brazil were relatively less affected by the crisis, and some even

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1. *Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development*, G.A. Res. 63/303, at 4, U.N. GAOR, 63rd Sess., 95th plen. mtg., U.N. Doc A/RES/63/135/ (July 13, 2009) [hereinafter U.N. Conference].
 2. For example, the G-20 publicly assumed that the causes of the current financial crisis are rooted in inadequate appreciation of the risks taken in an economic expansion period, failure to exercise proper due diligence, and "weak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and consequent excessive leverage." In addition, "[p]olicy-makers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions." Other fundamental factors were "inconsistent and insufficiently coordinated macroeconomic policies, inadequate structural reforms[.]" *G20 Declaration: Full text Summit on Financial Markets and the World Economy*, BBC NEWS, Nov. 15, 2008, <http://news.bbc.co.uk/2/hi/business/7731741.stm>.

ventured to talk not only about a decoupling effect but also about a reverse-coupling effect.³ According to this hypothesis, rising economies like China would become the locomotive that would drag the rich countries back from their economic black hole. This line of argument has now been largely abandoned. Instead, the crisis hit almost everyone, and what a hit it was! Still, notwithstanding the fact that it destroyed richness equivalent to one year of work of the whole world, the crisis has not rivaled in any aspect the chaos generated by the Great Depression of the 20th century. Many economies faced recession but very few, if any, fell into complete disarray.

In fact, the crisis has not affected every country in the same manner or with the same intensity. Some countries did suffer greatly while others were affected less. So far, Brazil is unmistakably in the second group.⁴ In general, rich countries (mostly the United States and European countries) seem to have endured the most devastating effects of the crisis.⁵ Because the crisis had financial roots, most of the countervailing measures were financial—such as assisting and financing banks with confidence and cash-flow issues by restructuring their debts and buying toxic assets from those overexposed to them. By providing liquidity and a bailout assurance, the general goal was to prevent a credibility crisis and the feared downfall of the whole financial market.⁶ Gradually, this strategy seems to have worked, but the effects of the crisis will be long felt and the future fiscal costs of the bailouts are unclear.

For Latin America, the main problem with the crisis was that it affected foreign demand for its products and services, while drastically reducing the excess international liquidity that financed a substantial part of the investments and expansion of those markets in the previous years.⁷ The same excess liquidity was responsible for the general valuation of stock markets in those economies. In addition, once the insecurity associated with the crisis was installed, the natural flow of capital from these emerg-

3. *Although, as soon as November 2007, the President of the Brazilian Central Bank was already stating that no country, including Brazil, was immune to an international crisis, even though it was much more prepared to face this specific crisis than the previous ones. See Toni Sciarretta, Brazil is not Immune to the Crisis, says Meirelles, FOLHA ONLINE, Nov. 12, 2009, <http://www1.folha.uol.com.br/folha/dinheiro/ult91u347977.shtml> (last visited Feb. 8, 2009).*

4. *Marcos Valadao & Nara Galeb Porto, Brazilian Response to International Financial Crisis, the Pre-Salt Discoveries by Petrobras and the New Free Trade Areas in the Cities of Brazil, 15 LAW & BUS. REV. AM. 673, 674 (2009).*

5. *Id.* at 674.

6. *Id.*

7. *Addressing the LA situation the ECLAC-UN report stated that: "As a result of the global economic crisis, the countries of Latin America and the Caribbean are faced with a marked fall in external demand for their goods and services exports and, with the exception of some Central American and Caribbean countries, with deteriorating terms of trade. Access to international financing is increasingly difficult to obtain, and currency markets are coming under strong pressure from capital outflows." U.N. ECLAC, The Reactions of Latin American and Caribbean Governments to the International Crisis: An Overview of Policy Measures up to 30 January 2009, at 3, available at http://www.eclac.cl/noticias/noticias/1/34991/2009-16-The_reaction_of_LAC_governments_WEB.pdf.*

ing economies to supposedly safer harbors put extra pressure on their balance of payments. All of that, combined with a sudden drop of commodities' international prices, announced a bleak future for those countries.⁸

As a result, the United Nations General Assembly recognized that:

"[t]he crisis has produced or exacerbated serious, wide-ranging yet differentiated impacts across the globe. Since the crisis began, many States have reported negative impacts, which vary by country, region, level of development and severity, including the following (i) rapid increases in unemployment, poverty[,] and hunger; (ii) deceleration of growth, economic contraction; (iii) negative effects on trade balances and balance of payments; (iv) dwindling levels of foreign direct investment; (v) large and volatile movements in exchange rates; (vi) growing budget deficits, falling tax revenues and reduction of fiscal space; (viii) contraction of world trade; (ix) increased volatility and falling prices for primary commodities; (x) declining remittances to developing countries; (xi) sharply reduced revenues from tourism; (xii) massive reversal of private capital inflows; (xiii) reduced access to credit and trade financing; (xiv) reduced public confidence in financial institutions; (xv) reduced ability to maintain social safety nets and provide other social services, such as health and education; (xvi) increased infant and maternal mortality; and (xvii) collapse of housing markets."⁹

Notwithstanding this undisputedly dreary scenario, until now most of these effects did not occur in Brazil. If they did, they occurred at a much lower intensity than expected. Brazil's resistance to the crisis, and its swiftness in leaving it, is somewhat remarkable for a country known for constantly living in crisis. We discuss at this point the expected impact of the crisis on Brazil and its real effect on the country.

A. UNEMPLOYMENT, POVERTY AND HUNGER

The first effects felt in countries associated with the crisis were the increase in unemployment, poverty, and hunger.¹⁰ It is always important to stress that about half of the Brazilian economy is conducted under shadow markets—informal channels like non-personified businesses. But because the formal and informal sectors are intrinsically interconnected, the formal rate of employment is a good proxy for the actual employment rate, which would be at least equal to the formal rate.

As we can see from Table 1, the unemployment rate in Brazil varies substantially across the years but has decreased in the last three years, a trend that is consistent with the rest of the Latin American region. In fact, as a late comer to the crisis, the unemployment rate in 2008 was substantially lower than in 2007, when the crisis started. Actually, during

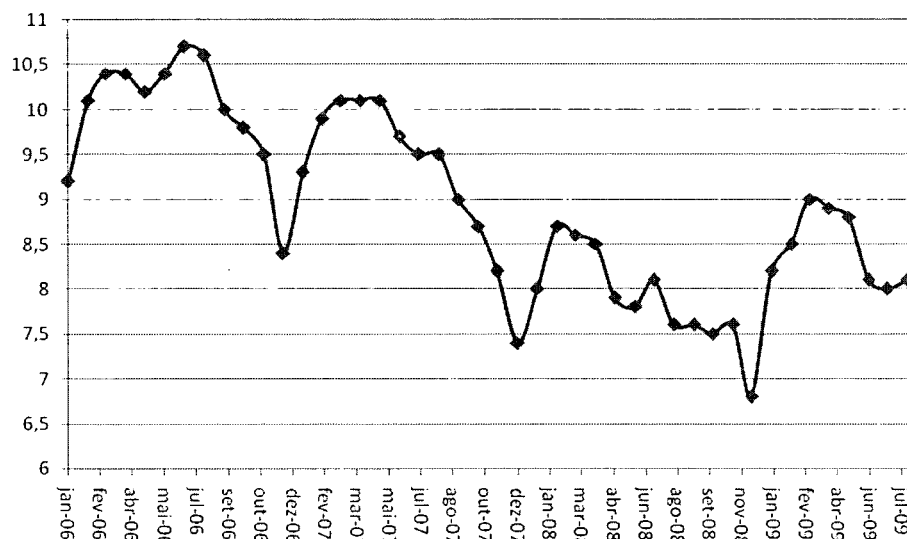
8. *Id.*

9. *U.N. Conference*, *supra* note 1, at 3.

10. *Id.*

the crisis the rate reached its lowest value (6.9%) in six years. We can also see that when the crisis finally hit Brazil at the end of 2008, there was a sharp increase in the unemployment rate, but by March 2009, it had resumed its descendent tendency.

TABLE 1: UNEMPLOYMENT RATE IN METROPOLITAN AREAS (30 DAYS)



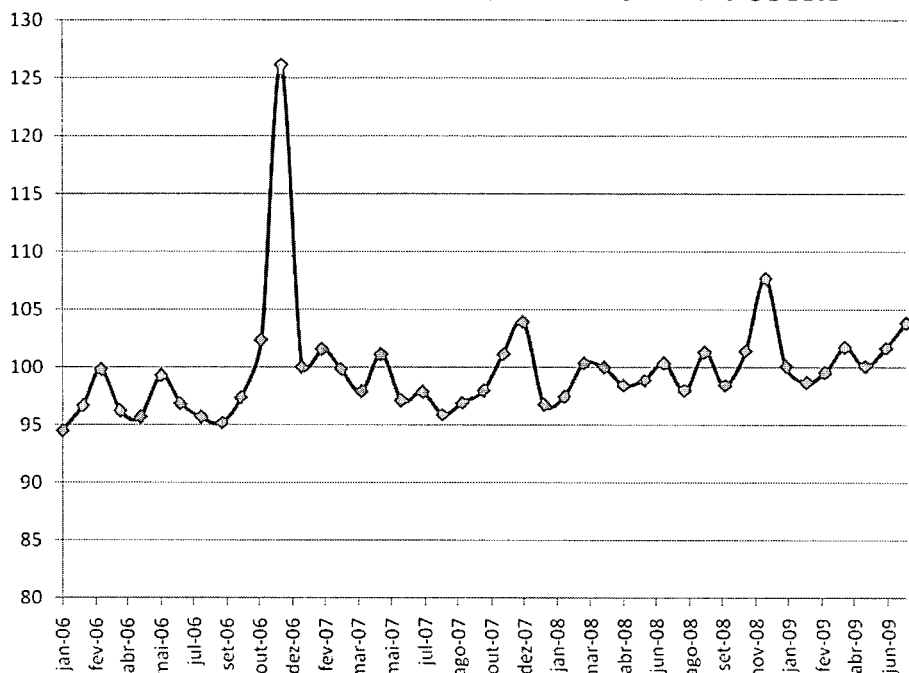
Source: IBGE/PME

Most importantly, the current unemployment rate is still below the pre-crisis levels, which indicates that although the crisis may have disturbed the historical descendent tendency, it has not yet reversed it. As a result, there is no sign of a rapid increase in unemployment in Brazil.

Additionally, because unemployment rates are not increasing, the income of the lowest-income workers should not be substantially affected. As Table 2 indicates, there is a historical trend in Brazil of an increase in the real wages workers receive, and the crisis has not affected this trend until now. Therefore, we expect the pattern of the last ten years to continue and do not expect increased poverty to be an issue in Brazil. Note that real income has increased in 2008 for all social classes in a proportional manner, and the income distribution has gradually improved since 2004. We all hope that the crisis does not interrupt this most welcome trend.

The combination of steady or decreasing unemployment rates and increasing real salaries do not lead to any expectation of rapid increases of hunger, although the challenge to maintain the growth pace without the global bonanza and the income increment with better distribution is a difficult puzzle to be solved.

TABLE 2: AVERAGE REAL SALARIES IN INDUSTRY



Source: FIPE

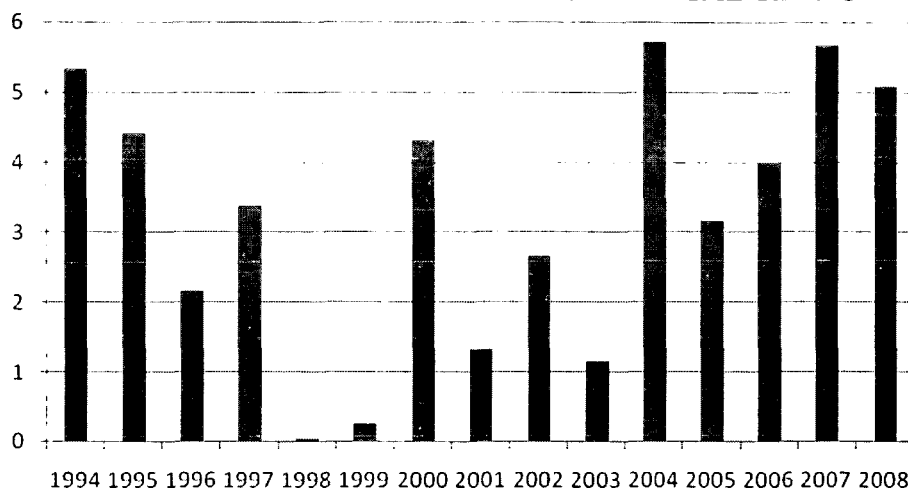
B. GROWTH DECELERATION AND POTENTIAL ECONOMIC CONTRACTION

It took so long for Brazil to display the impacts of the crisis that some considered it to be evidence of a decoupling effect while others hoped for a reverse-coupling effect. Although Brazilian resilience to the crisis proved strong, there were clear signs of substantial harm to growth and some questions about the future. Most commentators would agree that the financing model based on foreign capital will have to be tipped off to a domestic demand one, a historical challenge for Brazilian Governments.

As we can see from Table 3, since the Real Plan was introduced in 1994—a date that normally works as a benchmark for policy evaluation—Brazil's economy appeared to have taken off a number of times. But growth was repeatedly interrupted by external shocks like the Tequila Effect in 1994 (Mexico's reserve crisis), the Asian financial crisis in 1997 combined with the subsequent Vodka Effect in 1998 (the Russian's ruble crisis) that ended up with the Real abrupt devaluation in 1999 (the so called Samba Effect), followed by the Tango Effect in 2001 (Argentina's default crisis).¹¹ All of these events affected international capital flows

11. *The State of the World's Cities 2004/2005: Globalization and Urban Culture* 17 (United Nations Settlements Programme, 2004).

TABLE 3: ANNUAL GDP VARIATION IN REAL TERMS



Source: IBGE/SCN

and raised doubts about other developing countries, severely affecting Brazil. Brazilians began referring to this pattern of taking off and sudden landing as “chicken fly growth.”

Unfortunately, growth has been dramatically affected by the current crisis and it seems that history may have just repeated itself in 2009. Brazilian GDP growth in 2009 is expected to be zero or close to zero (either lightly negative or positive). In other words, we may be experiencing just another chicken fly. The good news is that just like in the other international crisis, Brazil is quickly recovering, and the expected GDP for 2010 may surpass five percent.¹²

Although the Brazilian economy grew more than five percent in real terms in 2008, in the last quarter it faced a substantial economic contraction, caused primarily by a sudden drop in the industrial sector that foresaw a substantial decrease in the world’s demand for its products. Even with a slighter intensity, contraction repeated itself in the first quarter of 2009 indicating that Brazil was technically in economic recession. The contraction was substantial and cannot be easily dismissed as just a bump.

12. Michael Mussa, *Global Economic Prospects as of September 2009: Onward to Global Recovery* (Sept. 17, 2009) (on file with the Peter G. Peterson Institute for International Economics), available at <http://www.iie.com/publications/papers/mussa0909.pdf>.

TABLE 4: QUARTERLY GDP VARIATION
(SEASONALLY ADJUSTED)

Economic Sector	2008.II	2008.III	2008.IV	2009.I	2009.II
Agriculture	4,2	(-) 1,5	(-) 2,0	(-) 1,4	(-) 0,1
Industry	1,1	1,6	(-) 8,0	(-) 3,2	2,1
Services	0,6	1,0	(-) 0,5	0,6	1,2
GDP at market prices	1,5	1,3	(-) 3,4	(-) 1,0	1,9*

Source: IBGE¹³. *Preliminary numbers

If, on one hand, it is clear that Brazil faced recession and all decoupling theories have been dispelled, then the preliminary numbers from 2009's second quarter may indicate that a quick recovery is imminent. If the numbers repeat themselves, Brazil may resume its growth path unexpectedly faster in 2010. Obviously, this is highly dependent on world recovery because another bump in the United States or another trading partners' economy could take Brazil down again.

In any case, Brazil is in a much stronger position to face a world recession now than in the previous years. According to the Central Bank, even after the crisis' first wave, the foreign reserves amounted to more than US\$223 billion,¹⁴ and the public debt nominated in dollar has been largely eliminated. This means that for the first time in the past few decades, Brazil actually has some leeway to implement counter-cyclical policies—discussed further in Item 0—that could actually alleviate the short-term impact of the crisis.

In short, Brazil was smacked right in the jaw by the international crisis, but prior fights taught us to take a punch without hitting the floor. The blow was quickly absorbed and an adequate response was implemented. The degree to which we will be able to recover depends not only on the recovery of the world economy, including commodity price levels, but also (and maybe more importantly) on the next government's ability to carry-out the necessary micro-reforms previously unchanged, as we move to more of an internal demand model of financing growth.

C. TRADE BALANCE AND BALANCE OF PAYMENTS

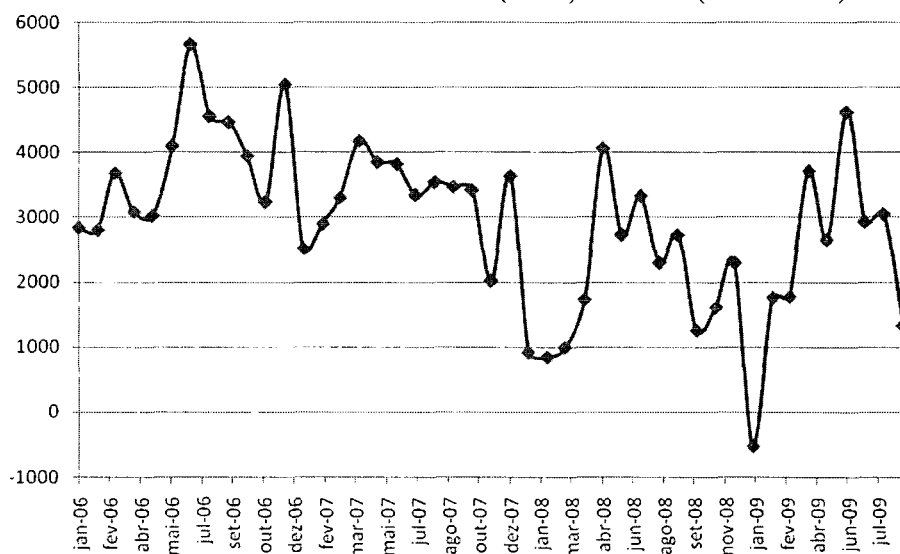
The most obvious effect of the crisis occurred in the trade balances due to the eminent economic contraction of the developed countries and the decreased imports by these countries that would provoke a contraction of world trade. For this reason, countries that could find room to push internal markets in order to tackle the crisis would have to adopt this strategy.

13. *Quarterly National Accounts, GDP Falls 0.8% from Q4 2008 to Q1 2009 in Seasonally Adjusted Series*, Brazilian Institute of Geography and Statistics (IBGE), June 9, 2009, http://www.ibge.gov.br/english/presidencia/noticias/noticia_visualiza.php?id_noticia=1384&id_pagina=1.

14. *Concept of International Liquidity*, Brazilian Central Bank, <http://www4.bcb.gov.br/?RP20090928>, [hereinafter BACEN].

The trade balance may be a topic of concern for Brazilian authorities, but not the most pressing one. It is clear from the table below that trade flows were highly affected in the beginning of 2008 and 2009, when the flow was negative for the first time in years. The trade balance also threatened a quick recovery in 2009, but the number's volatility does not allow us to make any predictions except that the balance will not be as positive in 2009 as it was in the previous years. This single fact may put some pressure in a country that has historically financed its public debt with export dollars, but the positive inflow of FDI (see Item 2.4 below) coupled with the growing foreign reserve (see Item 2.2 above) has largely mitigated this concern.

TABLE 5: TRADE BALANCE (FOB) IN US\$ (MILLION)



Source: BACEN, CBC Boletim/BP

Brazil has enjoyed a positive trade balance with the rest of the world in the last few years—to a large extent due to the substantial increase in commodities prices. We say “to a large extent” because commodities are a very important element of Brazilian export portfolio, making up forty-eight percent while the world average is at twenty-six percent. Brazil’s portfolio, however, is more diversified than other commodities specialized countries like Argentina (sixty-eight percent), Australia (sixty-two percent), or Russia (seventy-one percent).¹⁵ But, the crisis seems to have affected this distribution at least temporarily. The basic products share within Brazilian export portfolio increased from thirty-five to forty-two percent in the first six months of 2009, while the manufactured products

15. Fernando Puga, *The Specialization of Brazil in Map of World Exports*, ECONOMIST SAE, Sept. 10, 2007, available at http://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/conhecimento/visao/visao_36.pdf.

share fell from forty-eight percent to forty-three percent in the same period. Although some have argued that this was a potentially dangerous movement to export commodities dependence, but note the difference in the elasticity of commodities and industrialized products markets, combined with the fact that Brazil's greatest commodity client, China, is doing well, while most industrialized products buyers, like the United States and the rest of Latin America, are not doing so well.

Aware of these happenings, the government is working to tackle the emerging threat; though worldwide competitiveness is an issue highly discussed, it has rarely been worked on. In any case, it is clear that Brazil has generally enjoyed a positive trade balance in the last few years. Still, that balance dramatically shifted during the beginning of the crisis and just after its climax from 2008 to 2009. We can also see that a quick recovery may be on the way, but this recovery is unwarranted and will be somewhat dependent on the performance of Brazilian trading partners and their own ability to recover from the crisis. All the above mentioned facts, combined with a large foreign currency stock available at the BACEN, indicate that the trade balance may be still an issue for long-term growth. But since the balance was positive in 2008 and looks to remain so in 2009, all these facts may indicate that the bump did not represent a trend change.¹⁶

D. DWINDLING LEVELS OF FOREIGN DIRECT INVESTMENT—FDI

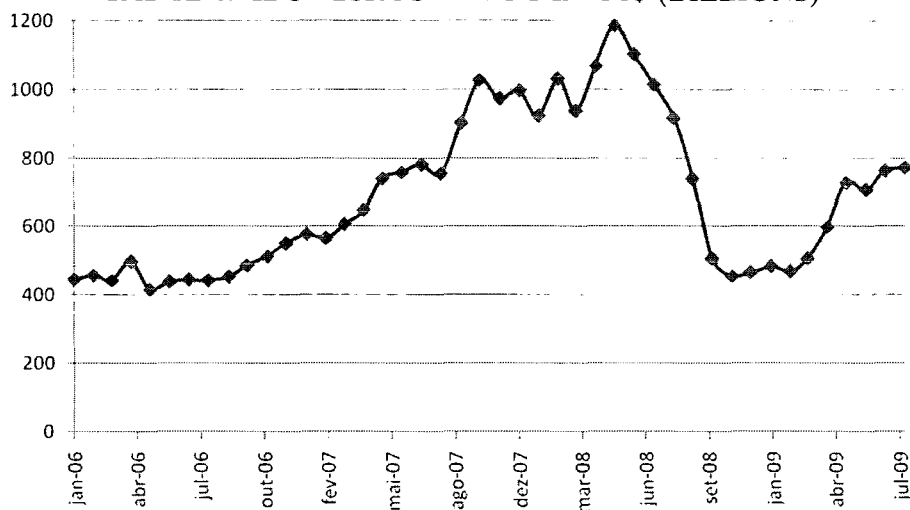
Anyone who observed Ibovespa's sharp decline from May to September 2008, when it reached its historical peak only to lose more than sixty percent of its value, will have to agree that the market did not believe that Brazil was immune to the crisis. In addition, it is tempting to affirm that there was a major capital exodus from Brazilian stock market as the crisis reached its climax. As wearisome as the situation may look, the actual results for FDI were not so substantial or clear-cut.

Indeed, Brazil initially suffered from a reduction in its FDI inflow as the crisis showed its amplitude in 2008 and 2009. But the stock market's behavior does not seem to have been motivated by fundamentals. As a matter of fact, in May, foreign direct investment in the productive sector totaled US\$2.483 billion—which is the highest result ever recorded by the Central Bank for May in more than sixty years of monitoring.¹⁷ Although the authorities expect a lower result for the following months, there are clear signs that FDI inflow is going to be substantially positive in 2009 (US\$25 billion). Some private analysts estimate the FDI results for the year as the third highest in the decade, only lower than in 2007 and 2008 when the volume of funds was recorded. As it seems, the majority reaction in 2008 only created great business opportunities for those investors that were quick and brave enough to take advantage of it.

16. See BACEN, <http://www.bcb.gov.br/pec/indeco/ingl/ie5-01i.xls>, *supra* note 14.

17. *Id.*

TABLE 6: IBOVESPA'S VALUE IN US\$ (BILLIONS)



Source: IBOVESPA

The Brazilian economy's lesser exposure to the international crisis was largely due to its low foreign debt nominated in dollars; thus the volatility of the international market had a reduced impact on public finance. As recognized by some analysts, the variation of Brazilian international payment flow is much more connected with changes in its industry's business cycle vis-à-vis the rest of the world than to its need of external financing.¹⁸ As previously mentioned, Brazil's substantial influx of FDI inflow has contributed to maintaining the international reserves above US\$200 billion (about thirteen percent of GDP).

As discredited as rating agencies are after the crisis, it is interesting to note that Moody's rating agency announced in September that Brazil has achieved Investment Grade category.¹⁹ Now the three most relevant rating agencies classify Brazilian Treasury bonds as investment grade, and this may reinforce the positive flow of FDI to the country.²⁰

18. *A change in the composition of Brazil's foreign liabilities—a phenomenon that predates the global crisis—is affecting the country's international payment flows. A sustained fall in foreign indebtedness has led to a gradual decline in interest payments[.] At the same time, increased attractiveness to foreign direct investment since macroeconomic stabilization in the 1990s, initially motivated by the government's large privatization programme, has led to an increase in profit and dividend remittances. Rising overall service payments can be attributed to the greater openness to trade and investment. As a result, because profit and dividend flows are much more sensitive to the business cycle than interest payments on debt, Brazil's current account is becoming increasingly sensitive to the business cycle and the difference between domestic and global cyclical positions.* OECD Economic Surveys: Brazil 2009, OECD, 2009, at 24-6, available at http://www.fazenda.gov.br/audio/2009/julho/OECD_Brazil_09.pdf.

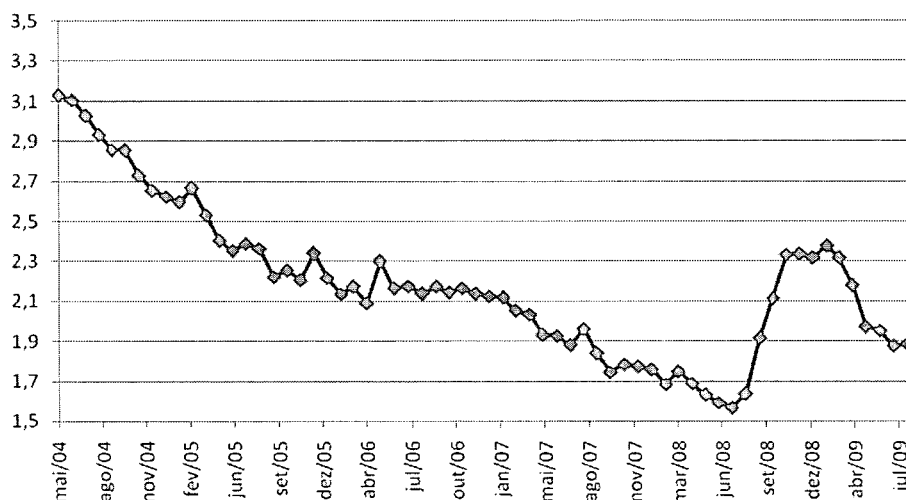
19. *Moody's Raises Brazil's Ratings to Investment Grade*, WALL ST. J., Sept. 22, 2009, <http://online.wsj.com/article/BT-CO-20090922-711270.html>.

20. *Brazil Becomes Investment Grade by Moody's*, Tesouro Nacional, http://www.tesouro.fazenda.gov.br/english/hp/downloads/Nota_Investment_Grade.pdf.

E. LARGE AND VOLATILE MOVEMENTS IN EXCHANGE RATES

As we can see, from July 2008 to July 2009, the Brazilian Real exchange rate behavior resembles a rollercoaster. The table below shows that the appreciation tendency over the last three years was abruptly interrupted in July 2008, only to resume its course a few months later. Note that the higher volatility period largely coincides with the bear market at Ibovespa (see Table 6 above).

TABLE 7: EXCHANGE RATE BRAZILIAN REAL
X US DOLLAR



Source: BACEN²¹

Curiously, some have argued that the recent appreciation of the Real before the dollar has also been a deteriorating element for the balance of payment. Nevertheless, as we can see from the table, it is true that the Real had a substantial appreciation in 2008, though it was followed by an almost equally quick depreciation in the following year that kept the real exchange rate at a lower level than in many years prior to 2007. Therefore, as much as Brazilian export associations keep complaining, the exchange rate does not seem to be an adequate argument for explaining the change in the export portfolio discussed in Item 2.3.

Of course, this high volatility affected Brazilian companies, mostly those that depended on foreign trade. In those cases, businesses that did not properly have hedge operation set up to protect against exchange rate exposure faced some difficulties. Indeed, some Brazilian companies like Sadia, a food tycoon, reported financial difficulties resulting from the exchange rate volatility, but actually it was more affected by a financial bet it took against the dollar than from the impact of the exchange rate on its

21. See BACEN, www.bcb.gov.br/pec/indeco/ingl/ie5-28i.xls, *supra* note 14.

sales itself.²²

As is common for situations like this in Brazil, the companies involved took advantage of the situation to create positive political momentum by trying to obtain antitrust clearance for a merger with its primary competitor, Perdigão, which for years was considered monopoly-resulting.²³ The same pattern can be identified in the Unibanco-Itaú merger, a transaction involving the third and the fiftieth Brazilian banks that has been negotiated for a long time and posed major antitrust issues.²⁴ Regretfully, the ever present National-champion “theory” gained additional power within the present government, and no political opposition was shown to either transaction.

In any case, although a volatile exchange rate is a reality, it seems that the Central Bank’s spot interventions have worked well enough to make the re-adjustment process less traumatic. In addition to that, the same general decrease in commodities prices that may negatively affect the balance of payment may, at least partially, prevent or mitigate the appreciation of the Real. A more competitive exchange rate, in turn, may boost exports in manufacturing, and that is a general trait of the diversified Brazilian economy. Most changes in the economic environment have positive and negative effects. Whether or not the exchange rate will favor or undermine exports remains to be seen.

F. GROWING BUDGET DEFICIT, FALLING TAX REVENUES AND REDUCTION OF FISCAL SPACE

Fiscal revenues are directly connected with the vigor of economic activities. As the GDP dropped dramatically in the last quarter of 2008 and in the first quarter of 2009 (see Table 4), so did tax revenues. The main sources of revenue loss were identified by the Federal Revenue Secretariat as the reduction in industrial production, companies’ turnover and profit, as well as a decrease in retail sales.²⁵

Nonetheless, the amount of revenue losses cannot be explained wholly by the economic slowdown since the Brazilian GDP had already recovered at the second quarter of 2009 (see Table 4). Still, revenues continue to decrease. A complete explanation must go beyond a mere economic

22. “The merger of Perdigão and Sadia, announced in May, came about after Sadia took a beating in last year’s stock-market mayhem. It was hurt when the dollar went from a weak BRL1.56 in July 2008 to as high as BRL2.60 in the post-Lehman Brothers chaos late last year. Sadia posted the first loss in its 64-year existence and reported a staggering first-quarter debt, a result of hedging against the U.S. dollar. Perdigão essentially become Sadia’s white knight.” Kenneth Rapoza, *Brazil’s New King of Food*, BARRON’S, July 13, 2009, <http://online.barrons.com/article/SB124727518474926343.html>.

23. *Id.*

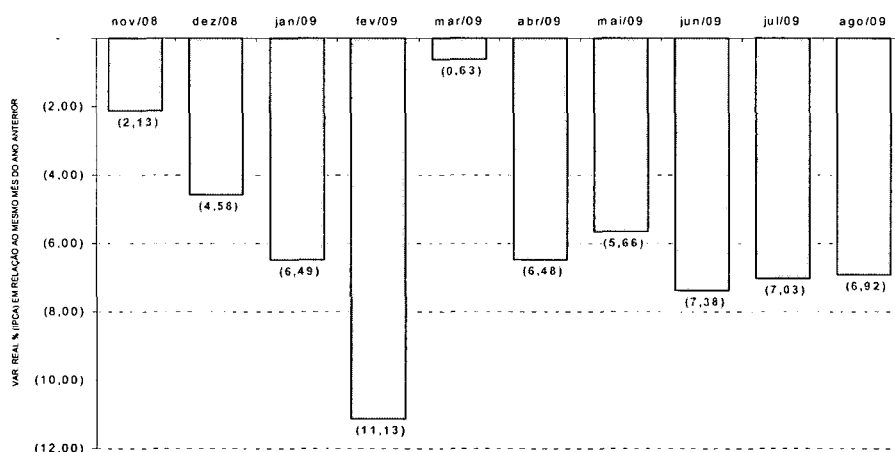
24. *Brazilian merger shuffles Latin American pack*, THE BANKER, July 7, 2009, <http://www.thebanker.com/news/fullstory.php/aid/6752>.

25. *Federal Revenue Collection Analysis–August 2009*, Federal Revenue Secretariat of Brazil, at 2-3, available at www.receita.fazenda.gov.br/Publico/arre/2009/AnaliseMensalago09.pdf.

slowdown. In our view, the significant sustained revenue losses resulted primarily from the many counter-cyclical measures that the government implemented in order to fight recession. Many of these measures involved substantial tax breaks for sectors considered strategic to overcoming recession (discretionary tax breaks). These tax breaks largely benefited the automotive industry, domestic appliances sector, construction materials, financial transactions, loans, and money exchange.²⁶

In addition to that, the Federal Revenue Secretariat attributes the revenue decrease to other additional factors such as an increase in tax compensation (due to tax offset for overpayment of corporate income tax in previous years).²⁷ One may also add to these explanations the usual tax default trend (illegal withholding of taxes by debtors) that usually happen in Brazil during economic crisis, even though this cannot be measured or confirmed.

GRAPH 8: FEDERAL REVENUE EVOLUTION
DURING THE CRISIS
(Real Value Y/Y Comparison-IPCA)



Source: Federal Revenue Secretariat of Brazil-RFB

The decline in federal revenues obviously imposes some budgetary restrictions for the government if an additional deficit and a negative overall effect are to be avoided. Indeed, the fiscal results for the public sector in 2009 are expected to be worse than 2008 and 2007.²⁸ A recent increase in the Tax on Financial Transactions (*Imposto sobre Operações Financeiras*-IOF) levied on foreign investment on the Brazilian financial

26. It is estimated at \$17.3 billion. *Id.* at 2-9.

27. *Id.* at 3.

28. See Brazil, Sustainable Economy, Brazilian Ministry of Finance/EXAME, n. 3, Apr. 2008, at 13, 16, available at http://www.fazenda.gov.br/portugues/docs/brasil-economia-sustentavel/edicoes/Brasil-Economia-Sustentavel-Edicao-4_ENGLISH.pdf.

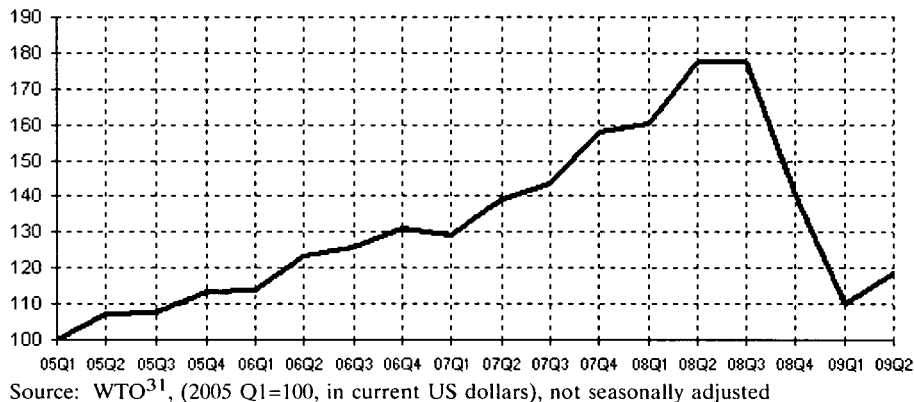
and capital markets went from zero to two percent in October 2009.²⁹ Although called a regulatory tax, it was said by some to be aimed at reducing fiscal deficit. But we believe that the estimated amount to be collected is not substantial enough to make a difference. Additional measures to increase tax revenues are expected.

As the counter-cyclical measures wear out and the economy recovers, a recovering of the government's numbers is expected. In any case, Brazil has one of the lowest levels of nominal debt compared to countries like the United States, United Kingdom, Saudi Arabia, India, Russia, Japan, France, Italy, Germany, and China,³⁰ and fiscal debt seems to be under control (see Item 0 below).

G. CONTRACTION OF WORLD TRADE

The crisis clearly decreased world trade. Graph 9 below shows how the world trade, measured by scale merchandise export, had a massive reduction from the third quarter of 2008 to the second quarter of 2009.

GRAPH 9: QUARTERLY WORLD MERCHANDISE EXPORT DEVELOPMENTS (2005-09)



The abrupt reduction in the world trade volume as a whole indeed had some effect on the Brazilian economy. But surprisingly for some the impact was actually very limited. Despite the fact that Brazil is a growing participant in world trade in recent years, the truth is that the country is still very closed when compared to other countries. Brazil was responsible for barely more than one percent of world trade in 2007.³² And this famished scenario is expected by some to either stabilize or decrease in

29. *Foreign Capital in Brazil*, at 20, http://www.brasil.org.pl/forms/inv_company_information_in_brazil.pdf.

30. See *Brazil, Sustainable Economy*, *supra* note 28, at 9.

31. *Short-term Merchandise Trade Statistics*, World Trade Organization, http://www.wto.org/english/res_e/statistics_e/quarterly_world_exp_e.htm.

32. *World Trade Developments*, World Trade Organization, 2008, at 3, http://www.wto.org/english/res_e/statistics_e/its2008_e/its08_world_trade_dev_e.pdf.

the following years.³³ When it comes to commercial services, the Brazilian share is even smaller.³⁴ In a country so closed to international trade it is not difficult to see why the sudden drop in world trade volume had very limited economical impact.

To make the world trade downfall even less relevant to Brazil, it is important to remember that our export portfolio is highly spread around the globe. The crisis is somewhat concentrated in the United States and in some European countries, but these countries represent only about fifty percent of Brazilian foreign customers.³⁵ The rest of our production is shipped to Latin America, Africa, Asia and other countries.³⁶ In 2007, Brazil exported US\$32 billion to North America, US\$38 billion to South and Central America, US \$43 billion to Europe, US\$9 billion to Africa, US\$6 billion to the Middle East, US\$4 billion to CIS, and US\$26 billion to Asia.³⁷ This diversification eased some of the impact of the trade retraction and clearly worked as a positive factor to partially insulate the Brazilian economy from the crisis.

H. INCREASED VOLATILITY AND FALLING PRICES FOR PRIMARY COMMODITIES

According to the IMF report on the implications of the global financial crisis for low-income countries, particularly in Latin America, Africa, and the Middle East, commodity exporting countries would have to deal with a “sharp decline in commodity prices.”³⁸ Also, in Latin America growth is expected to be restricted by a decrease in external demand (notably from the United States), and financial conditions are “expected to slow from [4.5%] in 2008 to [1%] in 2009.”³⁹ The IMF Report also states that “food prices are likely to be less affected by the” crisis because “food demand is less income-elastic than other commodities.”⁴⁰

On one hand, since 1978 Brazil has exported more manufactured products than commodities, and this may indicate that the decrease in the commodities price level may have an adverse impact on Brazil, but again of limited intensity.⁴¹ Furthermore, the second item in the commodities export portfolio is food, which may help alleviate the impact of price de-generation. On the other hand, as discussed above, the demand reduc-

33. *Ernst & Young, Brasil Sustentável: Horizontes da competitividade industrial* (2009), available at [http://www.ey.com/Publication/vwLUAssets/Brasil_Sustentavel_Horizontes_da_competitividade_industrial/\\$FILE/Brasil_Sustentavel_-_Competitividade_industrial.pdf](http://www.ey.com/Publication/vwLUAssets/Brasil_Sustentavel_Horizontes_da_competitividade_industrial/$FILE/Brasil_Sustentavel_-_Competitividade_industrial.pdf).

34. *WTO, World Trade Developments*, *supra* note 32, at 15.

35. *Id.* at 4.

36. *Id.*

37. *Id.*

38. *Int'l Monetary Fund, The Implications of the Global Financial Crisis for Low Income Countries*, at 3 (2009), available at http://www.wto.org/english/res_e/statis_e/its2008_e/its08_world_trade_dev_e.pdf.

39. *Id.*

40. *Id.* at 4.

41. See Remburssi, *Gateway to Brazil*, http://www.remburssi.org/projects/brazil/Part_II.htm (last visited Nov. 12, 2009).

tion for manufactured products was substantial enough to tip the export portfolio in favor of commodities for the first time in more than thirty years.⁴²

The portfolio modification is considered by the export sector and the government as a potential problem, and some counteracting measures are being considered. Nonetheless, we believe that this temporary portfolio modification is much more related to the fact that consumers of manufactured products (United States and the Americas) were more affected by the crisis than commodities consumers (China and Asia). As a result, it is unclear whether governmental measures would be effective.

I. DECLINING REMITTANCES TO DEVELOPING COUNTRIES

As with any developing country, Brazil is expected to receive less portfolio investment as the world gets more restrictive. However, this general trend has been highly mitigated or even blocked by the fact that Brazil was upgraded to investment grade by the three major rating companies in 2008 and 2009, despite the crisis and as a result of the quick economic recovery during the recession.⁴³ This perception was clearly reflected in Bovespa's impressive recovery, as we can see from Table 6 above.⁴⁴ As a result, even if the portfolio investment in Brazil decreased, foreign direct investment was more than sufficient to sustain the balance of payments.⁴⁵

J. SHARPLY REDUCED REVENUES FROM TOURISM

Once more, although the phenomenon was somewhat felt, its relevance is much more minimal than expected for the Brazilian economy. A sharp decline in revenues from the tourism sector is expected due to the high income-elasticity of tourism-related activities, which applies to leisure in general. Even if that becomes the case, the tourism share in Brazilian GDP is restricted to 3.6%.⁴⁶ Beyond the limited relevance of tourism for the Brazilian economy, a large part of tourism activity is composed of

42. IBGE, *supra* note 13.

43. Lisa Schineller & Sebastian Briozzo, *Research Update: Brazil Long-Term Foreign Currency Rating Raised To Investment-Grade 'BBB-', Outlook Stable*, STANDARD & POOR'S RATINGS DIRECT, Apr. 30, 2008, at 2.

44. Yahoo Finance, IBOVESPA -(BVSP), <http://finance.yahoo.com/echarts?s=%5EBVSP#chart2:symbol=^bvsp;range=20041109,20091110;indicator=volume;charttype=line;crosshair=on;ohlcvvalues=0;logscale=on> (last visited Nov. 11, 2009).

45. *Accordingly to the OECD Report: "Its [balance of payments] continues to be financed comfortably by robust FDI inflows, which more than offset the decline in portfolio investment as the global financial environment weakened in the second half of 2008. As a result of a positive balance of payments position, international reserves continued to be accumulated until late in 2008, when the central bank launched a number of liquidity enhancing measures and intervened sporadically in the foreign exchange market. . . . International reserves stood at close to USD 200 billion in May 2009 (about 13% of GDP)." OECD, supra note 18, at 24.*

46. See Pedro Soares, *Turismo representa só 3.6% do PIB*, Folha de São Paulo, DINHEIRO, June 4, 2009, <http://imprensa.spturis.com/imprensa/clipping/files/090604/3.pdf>.

internal tourism that was not highly affected by the crisis because income was not severely effect, as discussed in Item 0 above.

In addition, while income shortage in developed countries may have reduced the inflow of international tourists, Real's temporary depreciation may have mitigated this effect for a while. It also reinforced Brazilians' tendency to travel within the country. Summing up, the decrease in tourism resulting from the crisis may adversely affect Brazil, but the impact is expected to be small with very few repercussions on the economy as a whole.

K. MASSIVE REVERSAL OF PRIVATE CAPITAL INFLOWS

Please refer to Items above.

L. REDUCED ACCESS TO CREDIT AND TRADE FINANCING

This was the most evident outcome of the crisis and was triggered by unsafe credit practices, which were finally proven to be more than a credit bubble. It would also affect the Brazilian credit market, even though the Brazilian banking system is not too "internationalized". The Brazilian Central Bank and the Ministry of Finance adopted appropriate measures (see comments on this issue in section 3) that have been enough to substantially mitigate the effects of the crisis so far.⁴⁷

M. REDUCED PUBLIC CONFIDENCE IN FINANCIAL INSTITUTIONS

Wherever it was felt, the reduced confidence in financial institutions was a phenomenon intrinsically attached to the crisis. Because some financial institutions went bankrupt abroad and many others threatened to fall, a feeling of insecurity spread throughout the population of many countries where those banks transacted more heavily. This was not the case for Brazil.

The Brazilian banking sector is much more concentrated than in most developed countries. Additionally, an environment of hyperinflation, constant change of currency, and financial rules combined with many international crises forged one of the most flexible and technologically sophisticated banking systems in the world. The system is still largely

47. *The OECD Report states: "The central bank took decisive action to enhance liquidity in the domestic money market by reducing compulsory reserve requirements for banks, which have traditionally been tight, by some 3.5% of GDP during September-December 2008. The authorities also created incentives for larger financial institutions to purchase the loan portfolios of smaller banks, which were affected particularly adversely by the deteriorating credit environment. As in previous periods of financial distress, interventions in foreign-exchange markets were carried out in a transparent manner; they were aimed at ensuring liquidity in periods of thin trade and geared towards smoothing excessive volatility in the exchange rate. The relaxation of the monetary stance as from January 2009 has been appropriate; it has brought real ex ante interest rates to historically low levels. There may well be room for some further monetary easing in the near term, depending on the strength of the recovery and the evolution of inflation expectations over the coming months."* See OECD, *supra* note 18, at 9-10 (emphasis in original)

centered on national capital, either private or public, with little activity abroad. Most international banks entered the market through mergers and acquisitions and their importance is growing steadily, though they are still responsible for only around twenty-five percent of lending and hold only twenty percent of the deposits.⁴⁸

The fact that the Brazilian banking system is one of the most regulated in the world, combined with a local focus explains in a larger measure why the financial crisis did not hit Brazil so hard in the financial sector. As a general rule, the local banks were much less exposed to risks than their North-American and European counterparts (better Basle index than the standard recommendation⁴⁹), and almost none took part in the derivatives festival. Obviously some confidence disturbances were felt and some deposit transfers from private to public banks happened (there is a general belief that public banks and financial institutions are less likely to go bankrupt), but general confidence was not really shaken.

Notwithstanding the fact that the Brazilian financial sector was healthy and almost free of toxic assets, some banks used the threatening environment to conduct mergers that would normally raise antitrust concerns (e.g. Itaú-Unibanco merger), and the Government created strong incentives for the larger banks to buy the portfolios of medium or small banks, furthering the historical trend for concentration, including in the credit market. In any case, to close the argument, it is enough to say that Brazilian banks closed 2008 with large profits, only 2.8% lower than in 2007 and behind only Petrobras.⁵⁰ Therefore, we may say that confidence in the financial institutions is not an issue in Brazil right now.

N. REDUCED ABILITY TO MAINTAIN SOCIAL SAFETY NETS AND PROVIDE OTHER SOCIAL SERVICES, SUCH AS HEALTH AND EDUCATION

As we have shown, public finances were adversely affected by the crisis, and the revenue losses clearly will impose some budgetary constraints

48. *Since the debacle of hyperinflation, Brazil has faced an aggressive concentration process in the banking system. In the last eleven years, the number of operating banks dropped 32.2%. For the sake of illustration, in 2007, Brazil had only 156 banking enterprises, while Germany registered 2,130 and the United States 7,282. Ministro Guido Mantega, Atravessando a Crise Mundial Conselho Politico [Presentation Before the Political Council of the Republic: A Way Through the Global Crisis] (Feb. 18, 2009), available at www.fazenda.gov.br/portugues/documentos/2009/p180209-conselho-politico.pdf.*

49. *The Basle index indicates bank assets risk exposure. Average Brazilian bank sector Basle index is 6.5% while Basle recommendation is 8%. See Ministro Guido Mantega, Atravessando a Crise Mundial Conselho Politico [Presentation Before the Political Council of the Republic: A Way Through the Global Crisis] (Feb. 18, 2009), www.fazenda.gov.br/portugues/documentos/2009/p180209-conselho-politico.pdf. [hereinafter Guido Mantega].*

50. *See Estado, Petrobras tira bancos do topo dos lucros em 2008*, Mar. 4, 2009, http://www.new.divirtase.uai.com.br/html/sessao_28/2009/04/03/ficha_ciclopalestras/id_sessao=28&id_noticia=9560/ficha_ciclopalestras.shtml; see also *Especial Lucro dos Bancos*, <http://www.feebpr.org.br/lucroban.htm> (last visited Nov. 9, 2009).

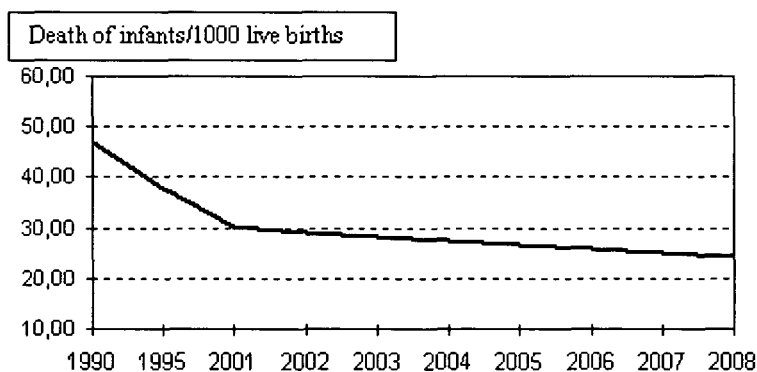
on the Brazilian Government. But as discussed, the Brazilian economy is already reacting, and we are no longer in a recession. Now, most of the revenue losses are attributable to counter-cyclical measures that probably will no longer be in place in 2010 (see Item 0 below).

On the top of that, the Brazilian social security net is very extensive and to a large extent imposed by the Constitution with earmarked contributions (in lieu of “taxes”), which fund the system encompassing public health and education systems. This straitjacket policy largely refrains from any conjuncture temptation to reduce social expenditures and, with the reemerging economy, funding will be available again. In sum, the decrease in public revenues was not sufficient to cause any serious damage to social safety nets.

O. INCREASED INFANT AND MATERNAL MORTALITY

The expected increase in infant and maternal mortality is also linked to the expected scarcity of public resources to fund social programs aimed at reducing these events. As explained above, to our knowledge, there was no substantial budget cut in any program associated with such mortality and because revenues are likely to return in 2010, no future cut is foreseeable. In fact, the rates for infant and maternal mortality in Brazil have been declining steadily in recent years and will probably not reverse its trend due to the crisis.⁵¹ For illustrative purposes, Graph 10 below shows the continuous decrease in infant mortality from 1990 to 2008:

GRAPH 10: INFANT MORTALITY IN BRAZIL



Source: IBGE⁵²

51. *Index Mundi, Brazil Infant Mortality Rate*, http://www.indexmundi.com/brazil/infant_mortality_rate.html (last visited Nov. 11, 2009); MDG MONITOR, *Tracking the Millenium Dev. Goals*, http://www.mdgmonitor.org/factsheets_00.cfm?c=BRA (last visited Nov. 11, 2009).

52. *Instituto Brasileiro de Geografia e Estatista, Taxas de Mortalidade Infantil 1990-2008*, http://www.ibge.gov.br/brasil_em_sintese/populacao09.htm (last visited Nov. 10, 2009).

P. COLLAPSE OF HOUSING MARKETS

Because the crisis originated in the sub-prime market and was interconnected with the housing bubble in the United States, it was reasonable to expect that the crisis would adversely affect the housing market elsewhere. But this expectation does not apply to Brazil. The housing market did not become dismal primarily because there was no such bubble locally. The banks were not involved either directly or indirectly in the financial festival of the derivatives. In addition, Brazil still has a large habitation deficit that will take years to be reduced substantially. This deficit puts considerable pressure on the demand side and prevents price level decreases.

In any case, because the crisis affected the economy as a whole, some effects were felt by the construction sector in general—including the housing sector, which grew substantially in the previous years and generated jobs. Aware of this negative impact, the government quickly put in place big stimulus packages for construction companies to finance their activities and gave discretionary tax breaks for inputs. Additionally, these public financial institutions rapidly expanded their lines of credits to compensate the growing risk aversion in the market, mainly for the housing sector to maintain and create demand for this strategic sector (see Item 0 below). All of this combined with the lowest interest rates in decades was sufficient to prevent a substantial deterioration of the housing market in Brazil that remains sound and growing.

As we can see, in many aspects, the anticipated impact of the crisis was either non-existent or much more limited in Brazil than in other countries. This was in some ways due to historical limitations that now offered strategic advantages, and in some ways due to sound political reforms that took place prior to the crisis, such as the restructuring of the public debt profile and the raising of foreign reserves. Notwithstanding, the government actively took some measures to reduce the impact of the crisis, as Brazil is not isolated from the rest of the world. We discuss some of them in the next section.

III. BRAZILIAN RESPONSE TO INTERNATIONAL FINANCIAL CRISIS

As we have discussed, the Brazilian economy was very resilient in showing the effects of the financial crisis.⁵³ Even when the crisis was already affecting many strong economies around the globe, in July 2008 Brazil was still considered to be “prospering in terms of economic growth, running sound public economic policies, with strong macro economical fundamentals, and enjoying growing international confidence.”⁵⁴

53. See Mauricio Cardenas, *Global Financial Crisis: Is Brazil a Bystander?*, The Brookings Inst., Oct. 15, 2008, www.brookings.edu/opinions/2008/1015_financial_crisis_cardenas.aspx.

54. Valadao & Porto, *supra* note 4, at 674; see also Jonathan Wheatley & Richard Lapper, *Surfing a Big Wave of Confidence*, FIN. TIMES, Jul. 8, 2008, <http://www.ft.com/>

Regretfully, it did not last forever. After the second quarter of 2008, the crisis aggravated and started to show its ugly claws to the country. This time, though, Brazil was wearing more than just studded leather armor—it was wearing a full metal plate.

It is worth stressing some aspects of the Brazilian economic armoring: huge and still growing international reserves of more than US\$223 billion, an “investment growth rate [that] is higher than aggregate demand growth, [a] bank sector with better Basle index than the Basle recommendation,⁵⁵ and [controlled and decreasing] public debt.”⁵⁶

At first, all theses gleaming figures were not sufficient to insulate Brazil (it looks like even full plates have holes). Indeed, the rate of economic growth dropped vertiginously in the last quarter of 2008 and remained so in the following quarter.⁵⁷ Nevertheless, by the second quarter of 2009, growth resumed its pace (GDP was 1.9% higher than the previous quarter).⁵⁸ It certainly does not necessarily mean that the crisis is over for Brazil, but it is strong evidence that the Brazilian locomotive is getting back on track again.

It is important to note that the Brazilian Government adopted many measures and that there is no single place or official document where we can find all of them duly identified and explained. Overall, they seem to have worked very well, but as scholars, we are left with a bitter taste because we cannot really identify all of them and scrutinize them to learn for the future.

In any case, in the previous sections we mentioned some of the adopted measures and we would like to further discuss them here. The ECLAC report depicts that most of the measures implemented were organized into five major fields of action: monetary and financial policy, exchange-rate and foreign-trade policy, sectoral policies, labor and social policies,” and fiscal policy.⁵⁹

A. MONETARY AND FINANCIAL POLICY

The crisis, deepening in October 2008, threatened developing countries with a substantial retraction of capital flows and foreign investment, which was expected to adversely affect the exchange rate and external accounts. The resulting increase in risk aversion increased volatility and, as a result, reduced liquidity. In order to alleviate this problem, the government tried to partially compensate the reduction in foreign capital with public funds. In addition, since the banking legal reserve in Brazil is

cms/s/0/3eb2654a-4a45-11dd-891a-000077b07658,dwp_uuid=1b5d8778-472f-11dd-93ca-000077b07658.html?ncllick_check=1.

55. Valadao & Porto, *supra* note 4, at 674-675; *see also* Mantega, *supra* note 49.

56. *Id.* at 674-675.

57. *See* Instituto Brasileiro de Geografia y Estatista, *Contas Nacionais Trimestrais*, http://www.ibge.gov.br/home/estatistica/indicadores/pib/pib-vol-val_200902_10.shtm (last visited Nov. 10, 2009).

58. *See id.* for more details.

59. ECLAC, *supra* note 7, at 5.

very conservative when compared to world standards, liquidity could be easily created as the Central Bank saw fit just by relaxing the restrictions, and basically that is what was done.⁶⁰

In September 2008, four days after Lehman Brothers went down, credit was scarce and the Real faced a sudden depreciation in front of the Dollar. The Central Bank had to inject half a billion dollars on the table to calm down the market. The lack of foreign credit was perceived as affecting medium and small banks that faced difficulties finding financial capital. Foreseeing the potential necessity of a quick intervention, the Central Bank's "powers to intervene in failing financial institutions" were substantially broadened.⁶¹ The two major federal financial institutions, Banco do Brasil and Caixa Econômica Federal, were also "authorized to buy struggling financial institutions, as well as insurance . . . enterprises" and social security enterprises without having to follow the public procurement law.⁶²

The creation of an investment bank within the Caixa Econômica Federal (CAIXA-Banco de Investimentos S.A.) to buy the stock of real estate firms in trouble as well as other sectors was announced.⁶³ This bank would start with about a billion dollars of capital to invest, and this allowance would be valid until June 30, 2011.⁶⁴ These investments were meant to substitute IPOs or issue shares as a capitalization mechanism. The Central Bank was authorized to grant loans secured by loan portfolios to banks and other forms of financing were offered, including loans to companies to facilitate the refinancing of their external debts ("allocating up to US\$20 billion of the country's reserves").⁶⁵ Around 4,000 enterprises were expected to benefit from these measures.⁶⁶ Most measures were authorized by Provisory Measure n 443/2008 (Oct 2008), which was converted into law in March 2009.⁶⁷

"On [January 21st], 2009, the central bank cut its basic interest rate by

60. *The following measures were listed in an official publication (Brazil, Sustainable Economy, supra note 28, at 23) as measures adopted to assist the financial sector: INTER-BANKING MARKET: Reduce compulsory deposit and speed up rediscount operations, injecting US\$45.5 billion into the economy; STIMULUS FOR MARKET SOLUTION: (i) Reduction of the bank compulsory deposit conditioned to the acquisition of loan portfolios; (ii) Authorization for BB and CEF to be shareholders in financial institutions (MP 443); (iii) Creation of the company Caixa- Banco de Investimento (investment bank); (iv) Support to small and medium banks with extension of guarantees from US\$27 thousand to US\$9 million in CDB/RDB. See Brazil, Sustainable Economy, supra note 28, at 23.*

61. Valadao & Porto, *supra* note 4, at 675.

62. *Id.*; see also Lei No. 11.908, de 3 de Marco de 2009, available at <http://www.jusbrasil.com.br/legislacao/92233/lei-11908-09>.

63. *Id.*

64. *Id.*

65. ECLAC, *supra* note 7, at 12.

66. *Id.*

67. *Although Brazil is a Presidential country, the Constitution allows the President to issue law-like decrees in cases of urgency and relevance that are immediately legally enforceable. These decrees, called Provisional Measures, must be submitted hitherto to Congress for referral. The measures mentioned above were largely regulated by Medida Provisória n 443, October 21st, 2008 (Brazil). This PM was transformed*

100 basis points (from 13.75% to 12.75%).”⁶⁸ The decrease continued until the lowest historical level was reached on September 2009 at 8.75%. Although the market is already foreseeing some interest rate increases in 2010, this reduction has substantially helped mitigate the effects of the crisis and could signal a new low-level trend in interest rates for Brazil.

Many measures were taken during the previous months as the crisis developed. It is not our purpose here to list all of them, but the ones mentioned above represent how the crisis was fought in the financial sector.

B. EXCHANGE-RATE AND FOREIGN-TRADE POLICY

The lack of liquidity represented some difficulties to Brazilian exporters that needed to carry out transactions in the United States dollar. To mitigate this concern, foreign exchange (Forex) reserves were used to finance exports through “reverse auction of bank securities to backstop foreign trade.”⁶⁹ The contracts tie in to the repurchase of these instruments, thus maintaining the foreign reserves levels. Indeed, even after the crisis started affecting Brazil, the level of foreign reserves had been steadily increasing and had reached its historical level of \$225 billion by October 6.⁷⁰ The Central Bank was also “allowed to grant foreign-currency loans directly to private banks, exclusively to finance foreign trade transactions.”⁷¹

The Brazilian export sector, specifically the agricultural industrial sector, was facing financial problems due to financial leveraging through derivative instruments attached to Dollar and Real exchange rate (the exchange rate in July 2008 was roughly 1/1.6 and turned to 1/2.3 in Dec. 2008).⁷² Although the exchange rate is already returning to the pre-crisis levels, many exporters are still facing some difficulties in dealing with the natural volatility and gaining access to financial instrument required to effectively export. Some of these measures are being taken to mitigate these difficulties while markets return to normal activity level.

into law by the National Congress: *Lei No. 11.908, de 3 de Marco de 2009*, available at <http://www.jusbrasil.com.br/legislacao/92233/lei-11908-09>.

68. *ECLAC*, *supra* note 7, at 12.

69. *ECLAC*, *supra* note 7, at 11.

70. *Banco Central do Brasil, Reservas Internacionais*, <http://www4.bcb.gov.br/?RP20091006> (last visited Nov. 10, 2009).

71. *ECLAC*, *supra* note 7, at 11.

72. *Efforts to Face the Crisis*, SUSTAINABLE ECONOMY (Ministry of Fin., Brazil), Apr. 2009, at 23 http://www.fazenda.gov.br/portugues/docs/brasil-economia-sustentavel/edicoes/Brasil-Economia-Sustentavel-Edicao-4_ENGLISH.pdf. (The following measures were listed as measures adopted to assist exporters: “Exchange Market and Export: Dollar auction in currency and in the future market (swaps). Dollar auction directed to the financing of Pre-shipment export financing (ACCs). Investment of part of the international reserves in the expansion of financing sources of Brazilian companies abroad.”).

C. SECTORAL POLICIES

In the oil and gas sector, the borrowing capacity of Petrobras and the National Bank for Economic and Social Development (BNDES) was expanded to around US\$5.3 billion “to keep up planned investment levels.”⁷³

In the agriculture sector, US\$6.5 billion was allocated to specific policies:⁷⁴

US\$2.2 billion as advances of resources from Banco do Brasil. US\$2.4 billion increase in resources that banks must earmark the agricultural sector. Increase in rate for compulsory rural savings deposits from sixty-five to seventy percent, which represents US\$1.1 billion. Use of Forex reserves to finance the rural sector through the intermediary of trading companies. Use of US\$200 million in resources from constitutional funds. US\$400 million in assistance for agricultural cooperatives. [and] allocation of US\$150 million to family agriculture using resources from the Workers’ Protection Fund (FAT).^{75, 76}

For the automobile sector, US\$1.8 billion from Banco do Brasil was made available to manufacturing banks for financing sales; motorcycle sales were boosted with fiscal incentives through discretionary tax breaks on financing (IOF reduction), acquisition (PIS/COFINS reduction), and ownership costs (decrease in the IPVA) of motorbikes.⁷⁷ In addition, a credit line of US\$182 million (US\$91 million from FAT and US\$91 million from Banco do Brasil) was opened to finance “working capital of used car dealers, upon guarantee of employment [level] maintenance.”⁷⁸ For the auto parts dealers and manufacturers, a credit line of US\$1.4 billion was also made available to finance working capital.⁷⁹

Regarding the housing market, one of the main instruments used by the Government was the traditional company, Caixa Econômica Federal. It created a credit line for working capital of US\$1.4 billion and simplified the collateral requirements for lending and increased the amount limits for the acquisition of building material (from US\$3.2 thousand to

73. ECLAC, *supra* note 7, at 11.

74. *Id.*

75. *The Workers’ Protection Fund (FAT) is a public fund composed of taxes (social contributions) mainly aimed at paying worker benefits of the unemployed.*

76. *Efforts to Face the Crisis, supra* note 72 (The following measures were listed as measures adopted to assist exporters: “Agribusiness Financing: Anticipation of BB [Bank of Brazil] disbursements [for agricultural loans]. Additional resources for various funds (US\$ 2.3 bi). Increase in directed credit with compulsory. A US\$ 227 million line for Center-Western producers. Expansion of the PGPAF (Price Guarantee for Family Agriculture Program) for the investment operations beginning on the 2008/2009 harvests. Creation of the LEC (Special Commercialization Line) during the 2008/2009 harvests. Extension of term for renegotiation of rural debts (after Law 11.775/2008).”).

77. *Id.* (IOF is a federal tax on loan transactions. IPVA is a state tax on property of vehicles. PIS/COFINS is a federal tax on sales of goods and services).

78. *Id.*

79. *Id.*

US\$11.4 thousand).⁸⁰ In addition, the Government changed regulations to allow up to five percent of the savings deposits to be invested in working capital operations for housing; reinforced real estate financing for the Federal Government employees by creating a credit line of US\$1.8 billion for Banco do Brasil and Caixa Econômica Federal; created a new housing program with subsidies directly from the Treasury in the amount of US\$7.3 billion; changed regulation to allow the use of workers resources at the FGTS to acquire housing that represented US\$1.1 billion from the Treasury and US\$3.4 billion from the FGTS itself;⁸¹ created a credit line of US\$2.3 billion from the Treasury to finance infrastructure; created a credit line of US\$0.9 billion from the Federal Union Grantor's Fund; created a credit line of US\$0.5 billion from BNDES to finance productive enterprises; and, finally, reduced the federal tax on manufactured products (IPI) on construction materials.⁸²

D. LABOR AND SOCIAL POLICES

The current government has been steadily increasing the real value of the legal minimum wage in the last years as an income redistribution strategy. Within this context, a twelve percent increase of the minimum wage was planned—before the crisis—to take place in 2009; it would increase the minimum wage to US\$211,⁸³ and the wages in the health and education of public servants were expected to rise by fourteen percent.⁸⁴ These wage increases were maintained, although interrupting them was seriously considered. As previously discussed, the expenditure levels in social programs like Bolsa Família⁸⁵ and investments within the Growth Acceleration Program (PAC) continue largely unaltered.⁸⁶ With all the other measures and the quick recovery of the economy, no additional social measures were required nor implemented.

80. *Id.*

81. *The Time of Service Guarantee Fund (FGTS) is a fund created with compulsory contributions from each worker in the private sector that is used by the Government to finance civil construction. The employee was previously allowed to withdraw his or her resources from FGTS only in specific cases, but mainly when the employer terminated the worker's labor contract.*

82. *See Brazil, Sustainable Economy*, *supra* note 28, at 23.

83. *Id.*

84. *ECLAC*, *supra* note 7, at 11.

85. *See generally* Anthony Hall, *From Fome Zero to Bolsa Familia: Social Policies and Poverty Alleviation under Lula*, 38 J. LAT. AM. STUDIES 689 (2006) (discussing the Bolsa Família program).

86. *See e.g.*, Marcos Valadao & Nara Porto Galeb, *Brazilian Response to International Financial Crisis, the Pre-Salt Discoveries by Petrobras and the New Free Trade Areas in the Cities of Brazil*, 13 L. & Bus. Rev. Am. 715, 717-719 (2007) (discussing the Growth Acceleration Programme (PAC)); Governo Federal, Programa de Aceleracao de Crescimento 2007-2010, at 5 (2007), available at www.fazenda.gov.br/portugues/releases/2007/r220107-PAC-integra.pdf.

E. FISCAL POLICY

In order to amplify the leeway for governmental policies to mitigate the effects of the crisis, a “reduction in [the] primary surplus target for 2009 from 4.3% to 3.8% of GDP” was initially considered.⁸⁷ But because the fiscal results were much worse than expected, the primary surplus target for 2009 was reduced to 2.5% and could be reduced further to 1.56% of the GDP.⁸⁸ Obviously this is not very positive news, but because Brazilian public debt grew very little during the crisis, it went from 41.8% of the GDP in August 2008 to 44% in August 2009. This is probably the lowest increase in the world, and the target for 2010 is 3.3% (although it may be reduced to something between 2% and 2.2%) The Brazilian position is much more comfortable than the position of many of its trading partners.⁸⁹

Although we would all like to see the target go up again, as a sound fiscal policy, the time for saving is not right now. The freed resources can be used to fuel anti-cyclical policies and to increase overall expenditure, and that is what the government has been doing. These resources have been used:

- (i) to inject over “US\$43.8 billion in the economy to keep up consumption levels;”
- (ii) to guarantee that Ministries are able to “bring forward spending and [to] ensure a parallel budget of at least US\$11.4 billion;”
- (iii) to make possible “fresh tax cuts and more resources” to the sectors more vulnerable;
- (iv) to protect \$9.2 billion already “earmarked for the Growth Acceleration Programme (PAC) in the 2009 budget;”
- (v) on projects, to “maintain overall demand” with resources from the Sovereign Fund (\$6.3 billion);
- (vi) by “federal State enterprises to release at least US\$17.5 billion in investment” in providing “inputs and raw materials” for the industry; and
- (vii) to finance “an advertising campaign to stimulate consumption.”⁹⁰

From the revenues perspective, the “Federal government and some state [governments] have extended the time allowed for monthly tax payments, thus easing pressure on corporate cash flows.”⁹¹ On top of that, as already discussed:

a series of tax cuts have been announced, totaling around US\$3.7 billion, in order to boost consumption:

87. ECLAC, *supra* note 7, at 10.

88. Cristiano Romero, *Union May Slow the Fiscal Target for 2010*, Valor Online, Oct. 16, 2009, http://www.valoronline.com.br/?impresso/caderno_a/83/5874102/uniao-pode-abrandar-a-meta-fiscal-de-2010.

89. *Id.*

90. ECLAC, *supra* note 7, at 10-12.

91. *Id.* at 12.

- (i) the tax on financial operations will be cut from 3% to 1.5% for direct consumer credit operations and the overdraft credit line;
- (ii) the tax on processed products was temporarily cut, until March 2009; for the purchase of motor vehicles with cylinder capacities of up to 1,000 cc., the tax will be cut from 7% to 0%, and for those up to 2,000 cc., from 13% to 6.5%; and
- (iii) the income tax tables for physical persons were revised⁹² [effectively] creating lower rates (7.55% and 22.5%) that favour the middle class, that is, those who earn up to US\$875 per month.⁹³

Finally, regarding taxes, some other measures were adopted in addition to the postponement of tax payments, acceleration in credit return procedures, and a 1.5% IOF reduction for foreign capital in fixed rate funds and bonds.⁹⁴

The government implemented all of the above mentioned measures to foster production and consumption and to mitigate the effects of the crisis. The measures were very successful in sustaining economic activities, although their impact on revenues is still very present and may present an issue if growth does not turn to revenues in the near future.

F. INVESTMENT AND PRODUCTION FINANCING

With respect to investment and production financing, the main measures were:

- (i) “maintenance of the TJLP [Long Term Interest Rate] on 6.25% p.y.” which is low for Brazilian standards;
- (ii) capitalization of the BNDES (in US\$45.5 billion) and transference of a line of credit of US\$2.3 billion from the World Bank;
- (iii) creation of a line of credit of more than US\$2.7 billion for “working capital, pre-shipping export and swing loans;” (iv) making ready to use of more than US\$4.5 billion of the Merchant Marine Fund;

92. The tax rates changes are depicted below:

Income tax rates-Individuals-Annual basis		
Taxable Income brackets (US \$)	Current tax rate	New tax rates
Not over \$7,825.03	Exemption	Exemption
Over \$7,825.03, but not over \$11,727.27	15%	7.5%
Over R\$11,727.27 but not over R\$15,636.	15%	15%
Over R\$15,636.54 but not over R\$19,538.18	27.5%	22.5%
Over R\$ 19,538.18	27.5%	27.5%

Note that there were only two tax rates before the change. It entered into force in Jan. 1st, 2009. Medida Provisória n 451, de 15 de dezembro de 2008, D.O de 16.12.2008, art. 15 (Assumed exchange rate US\$ 1.00 x R\$ 2.2) (Brazil).

93. *ECLAC*, *supra* note 7, at 10-12.

94. See Brazil, Sustainable Economy, Brazilian Ministry of Finance/EXAME, n. 5 Oct. 2009, at 3, 15-16, available at http://www.fazenda.gov.br/portugues/docs/brasil-economia-sustentavel/edicoes/Brasil-Economia-Sustentavel-Edicao-5_ENGLISH.pdf.

- (v) “[Second] Phase of the Revitalize Program” involving US\$1.8 billion for special financing credit lines for working capital, investments, exports (pre-shipping) that normally benefits shoes, leather, textile, cloths and furniture companies;⁹⁵
- (vi) “increase in Petrobras’ investment program”; and
- (vii) “continuity in the expansion of investments in infrastructure (PAC: additional \$64.6 billion in 2010).”⁹⁶

In the area of government investment, an increase of US\$4.2 billion in expenditures was established, “adding to the US\$16.6 billion already planned.”⁹⁷ The creation of a sovereign fund with an “initial amount of 0.5% of GDP (around US\$5 billion)” was agreed upon.⁹⁸ The government is aiming to use these funds to “provide the country with savings to compensate for any future economic fluctuations and finance the internationalization of Brazilian companies” through issuance of Treasury bonds.⁹⁹ The Unemployment Insurance Fund, FGTS, has also planned to release up to US\$2.5 billion for infrastructure investments.¹⁰⁰

IV. FINAL COMMENTS

We begin our final remarks by quickly comparing Brazil to the source of the financial crisis, the United States. While in the United States’ measures to face the crisis included restrictions on home loans to make them more secure to credit companies, in Brazil measures were adopted to make them easier. While in the United States concerns with inflation were put aside due to the urgency to push the economy out of recession, in Brazil the Central Bank was controlling the interest rates but with focus on the inflation rate, although the interest rate dropped substantially to help the country mitigate the crisis effects.

In Brazil the governmental financial enterprises are responsible for a large share of the banking activities (Banco do Brasil, Caixa Econômica Federal, BNDES, and other public banks) that grant some additional leeway for governmental actions. This tool was not available to our American counterparts. Furthermore, the banking sector is highly concentrated, and banking activities are heavily regulated by the Central Bank, making them less exposed to risk. These features are not encountered in the United States. The financial systems are strikingly different, and the perception of the banking system is different. Indeed, there is no need for the bank systems to be equal, or even similar; in other words,

95. See generally Programa Revitaliza, Ministério Do Desenvolvimento, Industria e Comercio Exterior, www.mdic.gov.br/sitio/interna/interna.php?area=2&menu=941 (last visited Nov. 16, 2009).

96. *Efforts to Face the Crisis*, *supra* note 72, at 12.

97. ECLAC, *supra* note 7, at 12.

98. *Id.*

99. *Id.*

100. *Id.*

“there is no one-size-fits-all financial system.”¹⁰¹ Different institutional arrangements within different institutional contexts lead to different results. Though all of this is true, it is also clear now that even with different institutional arrangements, world stabilization requires coordination.

The United States is where the “serpent’s egg” blossomed, but it is undeniable that the effects of the crisis have spread to all countries, including Brazil. Some were more affected, while some were less affected. The crisis became global. The circumstances for each country are different, and so were the remedies to tackle it. Brazil has done its homework and has constructed a financial system that is stronger now than before the crisis. It remains to be seen if the developed countries will take the opportunity to face their entrenched interests and construct a better international financial order. This may require restructuring the role and the effectiveness of the international financial institutions, especially the IMF and World Bank Group, and may require creating a formal international law-based institution that deals with the domestic and international regulation of the financial sector to replace the current Basle Committee and enforce universal accounting standards. Tax transparency, information exchange, and capital flow controls are also fields of high interest to maintain a system of effective surveillance of the international financial sector.¹⁰²

As can be seen from recent events, Brazil was rewarded for being highly responsible in its public policies and in regulating its financial system. Whether the country will actually be able to enjoy a windfall of public income in the near future—due to pre-salt oil resources that were meant to foster its development process, is yet to be seen.¹⁰³

Considering all the circumstances, the fact is that the whole world would benefit greatly if the lessons of the past could be learned and exploited to create a better international financial order. Brazil has been doing its part. The future will show how well the lessons of the past have been learned.

101. See United Nations Conference on Trade and Development, N.Y. & Geneva, 2009, *Financial Regulation: Fighting Today’s Crisis Today*, ¶ 37, available at http://www.unctad.org/en/docs/gds20091_en.pdf.

102. See G20 Pittsburgh Summit, Leaders’ Statement: The Pittsburgh Summit (Sept. 24–25, 2009) available at <http://www.pittsburghsummit.gov/mediacenter/129639.htm> (these three fields of action: regulation of international financial system (prudential banking regulation), with significant role to the new Financial Stability Board (FSB); tax transparency (by restructuring the role of the Global Forum on Transparency on Exchange of information for Tax Purposes), and the control of capital flows (recognizing the role of the FATF/GAFI), has been continuously highlighted by the G20 as fundamentals to deal with and to prevent such crisis. Nevertheless, other strategies to help poorer countries achieve a more efficient global development architecture should also be adopted).

103. See Valadao & Porto, *supra* note 4, at 679-80.

Comments and Casenote

